

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations,
Title 18, Section 1598.1, *Diesel Fuel Prepayment Exemption*

**SPECIFIC PURPOSE, PROBLEM INTENDED TO BE ADDRESSED, NECESSITY, AND
ANTICIPATED BENEFITS**

Current Law

California imposes sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code (RTC), § 6051.) Unless an exemption or exclusion applies, the tax is measured by a retailer's gross receipts from the retail sale of tangible personal property in California. (RTC, §§ 6012, 6051.) Although sales tax is imposed on retailers, retailers may collect sales tax reimbursement from their customers if their contracts of sale so provide. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700, subd. (a)(1).)

RTC section 6480.1 provides, in part, that at any time the diesel fuel tax is imposed or would be imposed on any removal, entry, or sale in this state of diesel fuel, the supplier shall collect prepayment of retail sales tax from the person to whom the diesel fuel is sold. For purposes of the imposition of the prepayment of sales tax on diesel fuel, RTC section 6480, subdivision (c), provides that the term "diesel fuel" is defined pursuant to the Diesel Fuel Tax Law (commencing with RTC section 60001). In addition, RTC section 6480.9 provides an exemption from the sales tax prepayment requirement on certain sales of diesel fuel for agricultural purposes, and requires a person purchasing diesel fuel that is exempt from the sales tax prepayment requirements to issue an exemption certificate to the seller in accordance with any instructions or regulations prescribed by the State Board of Equalization (Board).

The Board adopted California Code of Regulations, title 18, section (Regulation) 1598.1, *Diesel Fuel Prepayment Exemption*, in 2003. Regulation 1598.1 specifies the conditions under which the exemption provided in RTC section 6480.9 applies to the prepayment of sales tax on diesel fuel. Regulation 1598.1 also prescribes the exemption certificate required by RTC section 6480.9 and the appendix to Regulation 1598.1 contains an exemption certificate form, which may be used to claim the diesel fuel prepayment exemption.

In 2003, RTC section 60022, subdivisions (a) through (c),¹ expressly provided that:

(a) "Diesel fuel" means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle. However, a liquid does not possess this practical and

¹ The provisions of RTC section 60022, as amended by section 2 of Statutes 2001, Second Extraordinary Session 2001-2002, chapter 8, were effective from October 3, 2001, until December 31, 2006.

commercial fitness solely by reason of its possible or rare use as a fuel in the engine of a diesel-powered highway vehicle.

(b) “Diesel fuel” does not include kerosene.

(c) “Diesel fuel” does not include the water in a diesel fuel and water emulsion of two immiscible liquids of diesel fuel and water, which emulsion contains an additive that causes the water droplets to remain suspended within the diesel fuel, provided the diesel fuel emulsion meets standards set by the California Air Resources Board.

Subdivision (a)(4) of Regulation 1598.1 refers to RTC section 6480, subdivision (c), and RTC section 60022, incorporates the definitions from RTC section 60022 (2003), for purposes of defining diesel fuel, and, expressly provides the following:

“Diesel fuel,” for purposes of the imposition of the prepayment of sales tax, is defined in Revenue and Taxation Code section 6480(c) (by reference to Revenue and Taxation Code section 60022) and means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle. However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the engine of a diesel-powered highway vehicle.

Diesel fuel does not include gasoline, kerosene, liquefied petroleum gas, natural gas in liquid or gaseous form, or alcohol.

Diesel fuel does not include the water in a diesel fuel and water emulsion of two immiscible liquids of diesel fuel and water, which emulsion contains an additive that causes the water droplets to remain suspended within the diesel fuel, provided the diesel fuel emulsion meets standards set by the California Air Resources Board.

On January 1, 2007, RTC section 60022 was repealed and replaced by a new section 60022,² and the current provisions of RTC section 60022, subdivision (a), only provide that:

“Diesel fuel” means any liquid that is commonly or commercially known or sold as a fuel that is suitable for use in a diesel-powered highway vehicle. A liquid meets this requirement if, without further processing or blending, the liquid has practical and commercial fitness for use in the engine of a diesel-powered highway vehicle.

² The provisions of RTC section 60022, as added by section 3 of Statutes 2001, Second Extraordinary Session 2001-2002, chapter 8, and amended by section 17 of Statues 2003, chapter 605, became effect on January 1, 2007, and are still effective today.

However, a liquid does not possess this practical and commercial fitness solely by reason of its possible or rare use as a fuel in the engine of a diesel-powered highway vehicle.

“Diesel fuel” does not include kerosene, gasoline, liquified petroleum gas, natural gas in liquid or gaseous form, or alcohol.

Therefore, to the extent that Regulation 1598.1, subdivision (a)(4), includes the language from RTC section 60022, subdivision (c), which was repealed on January 1, 2007, the definition of diesel fuel in Regulation 1598.1 is no longer consistent with the current law.

Furthermore, subdivision (b) of Regulation 1598.1 lists a number of requirements that must be satisfied in order for the exemption provided in RTC section 6480.9 to apply to the prepayment of sales tax on diesel fuel sold to a retailer. As relevant here, subdivision (b)(4) of the regulation requires that “[d]uring the calendar year immediately preceding any purchases of diesel fuel, [the retailer] sold diesel fuel to diesel fuel consumers in which the gross receipts from such sales exceeded 25 percent of that retailer’s total taxable sales.” The last paragraph of subdivision (b) provides guidance about how to calculate the percentage referred to in subdivision (b)(4), and the guidance refers to amounts entered on specific lines of sales and use tax returns. However, when a taxpayer files its return via the Board’s online services, specific line numbers are not included.

Proposed Amendments

Need for Consistency

The January 1, 2007, repeal of the provisions formerly in RTC section 60022, subdivision (c), created an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)). This is because, as a result of the repeal of the provisions, the definition of diesel fuel in Regulation 1598.1 is no longer consistent with the definition of diesel fuel in the current provisions of RTC section 60022. Therefore, Board staff determined that it was necessary to amend Regulation 1598.1 so its definition of diesel fuel is based upon and consistent with the current definition of the term diesel fuel contained in section 60022 of the Diesel Fuel Tax Law, as provided in RTC section 6480, subdivision (c).

Interested Parties Process

The Board’s Business Taxes Committee (BTC) staff prepared draft amendments deleting the third paragraph from the definition of diesel fuel in subdivision (a)(4) of Regulation 1598.1. BTC staff subsequently prepared a discussion paper, and provided the discussion paper and its draft amendments to Regulation 1598.1 to the interested parties. On July 15, 2014, BTC staff conducted an interested parties meeting to discuss the draft amendments.

Since BTC staff did not receive any inquiries or written comments regarding its draft amendments during or subsequent to the July 15, 2014, interested parties meeting and staff had no changes to its recommendation to amend Regulation 1598.1, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously

scheduled to discuss staff's draft amendments. Staff also notified interested parties that comments could be submitted up to September 25, 2014, for consideration in the preparation of the Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

November 19, 2014 BTC Meeting

Subsequently, staff prepared Formal Issue Paper 14-009 and distributed it to the Board Members for consideration at the Board's November 19, 2014, BTC meeting. Formal Issue Paper 14-009 recommended that the Board approve and authorize publication of the amendments to Regulation 1598.1 (discussed above) to delete the third paragraph in Regulation 1598.1, subdivision (a)(4), so the regulation's definition of diesel fuel is consistent with the operative provisions of RTC section 60022. Formal Issue Paper 14-009 recommended that the Board revise the last paragraph in Regulation 1598.1, subdivision (b), so that it provides the same general guidance about how to calculate the percentage referred to in subdivision (b)(4) of the regulation, but without referring to amounts entered on specific lines of sales and use tax returns. Formal Issue Paper 14-009 also recommended that the Board replace the capital "A" with a lower case "a" at the beginning of the word "Article" in the appendix to Regulation 1598.1 to make the word consistent with the reference to "article" in subdivision (d)(1) of the regulation and consistent with the citation format prescribed in the California Style Manual.

During the November 19, 2014, meeting, the Board Members unanimously voted to propose the amendments to Regulation 1598.1 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1598.1 are reasonably necessary for the specific purpose of addressing the issue (or problem) created by the January 1, 2007, repeal of the statutory provisions formerly provided by RTC section 60022, subdivision (c), and ensuring that the regulation provides clear guidance to all taxpayers, including taxpayers who file returns via the Board's online services, about how to calculate the percentage referred to in subdivision (b)(4) of the regulation.

The Board also anticipates that the proposed amendments to Regulation 1598.1 will reduce confusion, promote fairness, and benefit sellers, retailers, Board staff, and the Board by providing a definition for the term diesel fuel that is consistent with the applicable statutory definition, and providing clear guidance about how to calculate the percentage referred to in subdivision (b)(4) of the regulation.

In addition, the Board has determined that the proposed amendments are not mandated by federal law or regulations, and there are no federal regulations or statutes that are identical to Regulation 1598.1 or the proposed amendments to Regulation 1598.1.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-009, the exhibits to the issue paper, and the comments made during the Board's discussion of the issue paper during its November 19, 2014, BTC meeting in deciding to propose the amendments to Regulation 1598.1 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1598.1 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1598.1 at this time because the Board determined that the proposed amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1598.1 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The proposed amendments make the definition for the term diesel fuel in Regulation 1598.1 consistent with the definition of the term in section 60022 of the Diesel Fuel Tax Law, in accordance with RTC section 6840, subdivision (c), and provide the same general guidance about how to calculate the percentage referred to in subdivision (b)(4) of the regulation, but without referring to amounts entered on specific lines of sales and use tax returns. The proposed amendments do not mandate that individuals or businesses do anything that is not already required by the Sales and Use Tax Law, and there is nothing in the proposed amendments that would significantly change how individuals and businesses would generally behave, in the absence of the proposed regulatory action, or that would impact revenue. Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and businesses. And, the Board has determined that the proposed amendments to Regulation 1598.1 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1598.1 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1598.1 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the

adoption of the proposed amendments to Regulation 1598.1 will not affect the benefits of Regulation 1598.1 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1598.1 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1598.1 may affect small businesses.